FRANCHISE SALES REGULATION REFORM: TAKING THE NOOSE OFF THE GOLDEN GOOSE

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Franchising is facing a crisis. This crisis has not been highly publicized, but as one tries to review objectively what is happening with franchising, and especially in light of the globalization of the world's economies, it is easy to conclude that the attractiveness of franchising in the United States—which I might characterize as a golden goose[1]—is being strangled by government intervention, forcing businesses to use other means to take their products and services to the market place. It is making franchising in the United States a less attractive means of distribution.
Is this "noose" necessary, or are there ways to loosen its grip on franchising and make franchising more viable and friendly to the business community?

Once upon a time, as the fairy tale would recite, franchising was an unregulated means of distribution.[2] In exchange for some kind of payment or payments, franchisors could freely contract with prospective franchisees, who would receive (1) the right to distribute the franchisor's goods or services using the franchisor's trademarks or service marks, and (2) the right to use the franchisor's system in connection with the sales of those products or services.[3] In addition, once the franchise relationship was

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[1] To my knowledge, the first reference to "franchising" in association with the word "gold" was by Andrew C. Selden, Esq. in his article, *Public Regulation of Franchising: Choking the Goose that Lays the Golden Eggs?*, 9 Franchise L.J. 1 (Fall 1989). In his title, Mr. Selden seems to imply that the gold is the derivative of franchising. I sense, however, that franchising itself is viewed as a golden idol; hence, my reference to it as a "golden goose," which is also the source of the fabled golden eggs.

[2] Franchising is often mistakenly referred to as an "industry." It is not. Franchising is one of several methods for companies to provide goods and services to others. According to recent statistics provided by the International Franchise Association ("IFA"), franchising is used in some 75 industries as a means of distribution. INTERNATIONAL FRANCHISE ASSOCIATION EDUCATIONAL FOUNDATION, THE ECONOMIC IMPACT OF FRANCHISED BUSINESSES (PricewaterhouseCoopers 2004), *available at* http://www.franchise.org/uploadedFiles/Files/EIS6_1.pdf.

[3] The legal definition of a "franchise" takes various forms. As noted in the text accompanying notes 5 and 6 *infra*, franchising is regulated at both the federal and state levels.

Federal regulation is under the auspices of the Federal Trade Commission ("FTC"), which has promulgated a trade regulation rule entitled, "Disclosure Requirements and Prohibitions Concerning Franchising," 16 C.F.R. § 436.1 *et seq.* (the "FTC Disclosure Rule"). Section 436.1(h) of the FTC Disclosure Rule defines a "franchise" as:

established, there were no governmental rules regulating the ongoing relationship between the franchisor and its franchisees. General contract law controlled this relationship, and under general principles of contract law, the parties could agree to almost any substantive terms governing their relationship, so long as their agreement did not violate public policy.[4]

Today, however, the environment in which franchises are sold and the ongoing relationships between franchisor and franchisee are hostile, at least from the franchisor's vantage point. Now, the franchise sales process is statutorily regulated in fifteen states[5] and by federal regulation, overseen

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> "[A]ny continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that:
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> (1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor's trademark;
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> (2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation; and
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> (3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.

Fifteen states also regulate the sales of franchises. Although the definitions of a franchise vary from state to state, § 14-201(c) of the relevant provision of Maryland's statute typifies the definition of a franchise. It provides: "Franchise" means an expressed or implied, oral or written agreement in which: (i) A purchaser is granted the right to engage in the business of business offering, selling, or distributing goods or services under a marketing plan or system prescribed in substantial part by the franchisor; (ii) the operation of the business under the marketing plan or system is associated substantially with the trademark, service mark, trade name, logotype, advertising, or other commercial symbol that designates the franchisor or its affiliate; and (iii) the purchaser must pay, directly or indirectly, a franchise fee. "Franchise" includes an area franchise. MD. CODE ANN., BUS. REG. § 14-201 (2008).

[4] For example, while the parties could freely negotiate the amounts which the franchisee would pay for the franchise rights, post-term non-competition provisions, being restraints on trade and generally not favored under public policy, had to be reasonable in time, scope, and territory. *See generally* COVENANTS AGAINST COMPETITION IN FRANCHISE AGREEMENTS (Peter J. Klarfeld ed., American Bar Association 2d ed. 2003).

[5] California (CAL. CORP. CODE § 31000 *et seq.* (West 2008)); Hawaii (HAW. REV. STAT. § 482E-1 *et seq.* (2008)); Illinois (ILL. COMP. STAT. § 705/1 *et seq.* (2008)); Indiana (IND. CODE ANN. § 23-2-2.5-9. (West 2008)); Maryland (MD. CODE ANN., BUS. REG. § 14-201 *et seq.* (2008)); Michigan (MICH. COMP. LAWS § 445.1501 *et seq.* (2008)); Minnesota (MINN. STAT. § 80C.01 *et seq.* (2008)); New York (N.Y. GEN. BUS. LAW §

by the Federal Trade Commission ("FTC"). At the federal level, prescribed disclosure is required before franchises can be offered for sale.[6] With the exception of Oregon, at the state level, in those fifteen jurisdictions where franchise sales regulations statutes have been adopted (the "Registration States"), both disclosure and registration with state officials are required.[7] In all but three of these states,[8] the registration application will be reviewed, and this review often results in a negotiation process between the state officials and the franchisor before the state officials will allow franchises to be offered for sale in their jurisdictions.[9]

In addition, nineteen states have statutes governing some aspect of the ongoing franchise relationship.[10] For example, these statutes may limit

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680.1 *et seq.* (McKinney 2008)); North Dakota (N.D. CENT. CODE § 51-19-01 *et seq.* (2008)); Rhode Island (R.I. GEN. LAWS § 19-28.1-1 *et seq.* (2008)); South Dakota (S.D. CODIFIED LAWS § 37-5A-1 *repealed by* S.D. SB 52); Virginia (VA. CODE ANN. § 13.1-557 *et seq.* (2008)); Washington (WASH. REV. CODE § 19.100.010 *et seq.* (2008)); Wisconsin (WIS. STAT. § 553.01 *et seq.* (2008)).

Each of these states will be hereinafter referred to as the "[Name of State] Registration Law." Oregon also regulates the sale of franchises, but it does not require any registration or filing. OR. REV. STAT § 3370.01 *et seq.* (2008). Hence, it is not considered one of the Registration States.

6 FTC Disclosure Rule § 436.2. *See* note 3, *supra.* The FTC Disclosure Rule initially went into effect in 1979. *See* 43 Fed. Reg. 59,614 (Dec. 21, 1978). It was recently amended, effective July 1, 2007. As amended, it will be hereinafter referred to as the "Amended FTC Disclosure Rule." *See* 72 Fed. Reg. 15,444 (March 30, 2007) (to be codified at 16 C.F.R. pts. 436 and 437).

7 *See supra* note 5.

8 Indiana, Michigan and Wisconsin.

9 It is important to note that the state regulators do not "approve" the registration or offer. To represent so may be a violation of state law. *See* Michigan Registration Law, § 445.1521. After the registration application to offer franchises for sale is acceptable to a state agency, the agency issues what is known as an effective order, indicating that the franchisor has been authorized to offer franchises for sale in that jurisdiction.

10 Alaska (ALASKA STAT. § 45.45.700 *et seq.* (2008)); Arkansas (ARK. CODE ANN. § 4-72-201 *et seq.* (West 2008)); California (CAL. BUS. & PROF. CODE § 20000 *et seq.* (West 2008)); Connecticut (CONN. GEN. STAT. ANN. § 42-133e *et seq.* (West 2008)); Delaware (DEL. CODE. ANN. tit. 6, § 2551 *et seq.* (2008)); Hawaii (HAW. REV. STAT. § 482E-6 *et seq.* (2008)); Illinois (ILL. COMP. STAT. 705/18-705/20 (2008)); Indiana (IND. CODE § 23-2-2.7-1 *et seq.* (2008)); Iowa (IOWA CODE § 523H.1 *et seq.* (2008)); Michigan (MICH. COMP. LAWS § 445.1527 (2008)); Minnesota (MINN. STAT. § 80C.14 (2008)); Mississippi (MISS. CODE ANN. § 75-24-51 *et seq.* (2008)); Missouri (MO. REV. STAT. § 407.400 *et seq.* (2008)); Nebraska (NEB. REV. STAT. § 87-401 *et seq.* (2008)); New Jersey (N.J. STAT. ANN. § 56:10-1 *et seq.* (West 2008)); Rhode Island (R.I. GEN. LAWS § 19-28.1-1 et seq. (2008)); Virginia (VA. CODE ANN. § 13.1-564 (2008)); Washington (WASH. REV. CODE § 19.100.180 *et seq.* (2008)); Wisconsin (WIS. STAT. § 135.01 *et seq.* (2008)).

Each of these statutes is hereinafter referred to as the "[Name of State] Relationship Law."

Most states also have statutes that govern franchise relationships in particular industries. See, e.g., GA. CODE ANN. § 13-8-2-11 *et seq.* (2008).

the franchisor's right to terminate franchises or not renew the franchises when they terminate;[11] restrict the franchisor's right to disapprove franchise transfers;[12] protect the franchisee's right to associate with other franchisees;[13] or to be free from excessive encroachment by other units flying the franchisor's flag.[14]

As a result of the foregoing regulations, today we see that a once easy-to-adopt method of distribution has become expensive and cumbersome, with increased legal exposure to franchisors who want to adopt this business model. How and why did this happen, and is there a possibility of reversing this trend? And if so, what will it take to do so?

This paper will first review the history of franchise regulation in the United States, revealing how franchising became so highly regulated. Next, it will delineate the inefficiencies of the current regulatory scheme. Third, it will identify the barriers to making franchising a more efficient means of distribution. And finally, it will present some of the models which could be adopted to overcome or reduce these barriers, and also comment upon the political feasibility of any serious reform. The focus of this paper will be on the franchise sales process; however, it is difficult to consider franchise sales reform without taking into consideration the franchise relationship issues as well.

I. THE HISTORY OF FRANCHISE SALES AND RELATIONSHIP REGULATION

Nineteen-seventy or thereabout was the red-letter year in franchise regulation. Before that time, franchises could be sold and managed by a franchisor without fear of governmental regulation. Only common law fraud limited what franchisors could say or not say during the sales process, and as most students learn in their first week of law school, fraud lawsuits are not favored by the courts, and generally, fraud is difficult to prove.[15]

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[11] See, e.g., Nebraska Relationship Law § 87-404 (terminations); Wisconsin Relationship Law § 135.03 (non-renewals).

[12] See, e.g., Michigan Relationship Law § 445.1527.

[13] See, e.g., Arkansas Relationship Law § 4-72-206(2).

[14] See, e.g., Hawaii Relationship Law § 482E-6(E).

[15] The law's dislike of fraud claims is demonstrated best by looking at the Federal Rules of Civil Procedure, which require that fraud claims be plead with a higher level of particularity than most other claims. FED. R. CIV. P. 9(b). Fraud is difficult to prove because of the number of elements that must all be successfully proven in order for a plaintiff to prevail on his claim: (1) the fact that a statement was made; (2) the statement was false; (3) the defendant knew the statement was false; (4) the plaintiff relied on the statement; (5) reliance was reasonable; (6) the false statement was the proximate cause of the plaintiff's damages; and (7) the extent of the damages. In the franchising context, the need to prove reliance and the reasonableness of that reliance are typically the major stumbling blocks for the aggrieved franchisee.

Thus, franchisees often found themselves without a viable remedy when they learned that they had bought the proverbial "pig in a poke."

Moreover, up to that point in time, once a franchise had been sold, the franchisor could generally handle its ongoing relationships with its franchisees as it so chose, limited only by the terms of the franchise agreement itself, and, perhaps, the implied obligation of good faith and fair dealing. [16] With almost no exceptions, franchise agreements are drafted by the franchisor or on its behalf by legal counsel.[17] Not surprisingly, these agreements were very franchisor friendly, which created an environment for abuse by the franchisor, the franchisor having been granted broad discretion in many areas of the franchise relationship, such as franchise transfers.[18]

For a few moments, let us address how franchising has developed as a powerful and popular business model in the United States. Franchising had been a sleepy means to distribute goods and services until the mid-1950s. Singer Sewing Machines is often credited as being the first major commercial franchisor, when, in 1851, it adopted franchising as the means to bring its products to the marketplace.[19] By the 1950s, franchising had become a hot ticket, as chains such as Holiday Inn, McDonald's, KFC and Dairy Queen established franchising as a method to achieve quick growth—combining the franchisor's proven system with the franchisee's capital and sweat equity, to expand operations at a far more rapid pace than would be

[16] The implied covenant of good faith and fair dealing has had an interesting history within the context of franchise law. The general rule is that in every contract there is an implied covenant of good faith and fair dealing; however, the implied covenant cannot be used to override an express provision in a contract. RUPERT BARKOFF & ANDREW SELDEN, FUNDAMENTALS OF FRANCHISING 120 n.2 (2d ed. 2004). While the black-letter law is generally applied, there have been many instances where the courts have twisted and turned to find a way to apply the implied covenant when following the strict application of the law might lead to what a court perceives as an unjust result. An interesting example of this phenomenon can be found in the franchise law famous case of Scheck v. Burger King Corp., 756 F. Supp. 543 (S.D. Fla. Jan. 15, 1991), *reconsid. denied,* 798 F. Supp. 692 (1992). *Scheck* was, in effect, later overruled by *Burger King Corp. v. Weaver,* (S.D. Fla. 1995), *aff'd,* 182 F.3d 938 (11th Cir. 1999). Even though *Weaver* effectively overruled *Scheck* with respect to Florida law, the language of *Scheck* appeared subsequent to the *Weaver* decision in Foodmaker, Inc. v. Quershi (Cal. Super Ct. Dec. 1, 1999).

[17] In my career of almost thirty-five years, I have only been called upon or been engaged in a transaction twice where a franchise agreement was drafted on behalf of a franchisee group, with the franchisor's consent. One time this occurred in the context of a franchisor bankruptcy, and even here, we used the franchisor's pre-bankruptcy form of franchise agreement as the starting point. The second time involved a major re-write where the franchisor had agreed to make significant concessions to the franchisees in exchange for the franchisees' commitments to make major upgrades to their physical facilities.

[18] *See* Larese v. Creamland Dairies, Inc., 767 F.2d 716 (10th Cir. 1985) (suggesting that a franchisor could provide that it could *arbitrarily* withhold consent to a proposed transfer of the franchisee's right in a franchise, if the franchise agreement so provided).

[19] BARKOFF & SELDEN, *supra* note 16.

achievable in a vertically integrated operation. It is thought that the franchisee, with its own capital at risk, would achieve a higher level of success to the overall franchise system than would operations overseen by managers who had less "skin" in the game. Hence, businessmen viewed franchising as a very attractive means to build their empires quickly and successfully.

The increasing success of franchising, however, led to abuse. During the 1960s in particular, franchise frauds increased and received more publicity, eventually leading to a call for regulation.[20] Franchisees had bought what they considered hot ticket business opportunities, only to find later that the strength of their franchisors and the likely success of their franchised opportunities had been exaggerated, and that their investments in their new businesses were worth considerably less than what they paid, if not worthless altogether.

At that point—1970—the regulatory tools available to government were useless to combat franchise fraud. Franchises are first cousins to securities in many respects in that both involve investment opportunities. However, securities regulations generally required the investment to be passive in order to be a "security," as demonstrated in the legendary *Howey* case,[21] where the court developed the currently well-established principle that the term "security" included investment contracts in which the success of the enterprise was dependent *solely* on the efforts of others—that is, the investment was passive in nature.[22] In contrast, in a franchise relationship, the franchisee typically has an active involvement in the enterprise. Thus, it was commonly thought that the securities laws did not provide an adequate tool to allow government to regulate the "Wild West" environment surrounding franchise sales.[23]

California provided the lead toward reform in the franchising environment. Its landmark legislation, the California Franchise Investment Law,[24] which was enacted in 1970 and went into effect on January 1, 1971, required franchise offerings to be registered with the California Commissioner of Corporations before franchises could be offered for sale or sold in that jurisdiction.[25] Numerous states followed California's lead, and by 1975, thirteen states had adopted laws similar to California's in the

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[20] MICHAEL SEID & DAVE THOMAS, FRANCHISING FOR DUMMIES 90-91 (2d ed. 2006) (hereinafter "*Dummies*").

[21] SEC v. W. J. Howey Co., 328 U.S. 293 (1946).

[22] *Id.*

[23] BARKOFF & SELDEN, *supra* note 16, at 120. For many years, plaintiffs tried to describe the franchisee's investment in his or her franchise as an investment involving "risk capital," thus making it a type of security. *See* John J. Michalik, Annotation, *What Constitutes an "Investment Contract" Within the Meaning of State Blue Sky Laws*, 47 A.L.R.3d 1375 (1973).

[24] Franchise Investment Law, CAL. CORP. CODE § 31110 (West 2007).

[25] *Id.* at §§ 31110–31111; Rule 4.2

franchise sales area.[26] During this period, franchise relationships also came under government scrutiny, and by 1975, sixteen states had adopted laws governing one or more aspects of franchise relationships.[27]

As compared to the aggressive regulatory initiatives of the states in the early 1970s, the federal government was the latecomer to the scene. The FTC began conducting hearings concerning abusive practices in the franchising community in 1971, and eight years later, its franchise rule, entitled Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, ("FTC Disclosure Rule") went into effect.[28] The FTC Disclosure Rule's requirements in many respects paralleled the disclosure requirements of the state registration laws, but there were notable differences between the state and federal regulatory attempts. One difference is that there is no registration requirement under the FTC Disclosure Rule. Second, while the state statutes gave aggrieved franchisees the right to sue their franchisors for misrepresentations made during the sales process or for failure to register altogether,[29] there is no private right of action for an aggrieved franchisee under the FTC Disclosure Rule—only the FTC can bring an action for a violation.[30] Third, the FTC Disclosure Rule does not regulate ongoing franchise relationships—an area that is still unregulated at the federal level, except in the petroleum and automobile industries.[31]

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[26] *See supra* note 5. The New York registration law listed in note 5 was in fact adopted in 1981. N.Y. GEN. BUS. § 683 (McKinney 2008).

[27] *See supra* note 10. The Iowa Franchise Act and Rhode Island Fair Dealership Act were in fact adopted in 1992 and 2007, respectively. IOWA CODE ANN. § 523H.1 (West 2008); R.I. GEN. LAWS § 6-50-1 (2007).

[28] Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, 16 C.F.R. 436 (1996). The FTC Disclosure Rule was amended in 2007, including the title. Its new title is Disclosure Requirements and Prohibitions Concerning Franchising. Business opportunities were initially subject to the FTC Disclosure Rule, but are now subject to a separate regulation, entitled, Disclosure Requirements and Prohibitions Concerning Business Opportunities, found in 16 C.F.R. 437 (2007). *See infra* text accompanying note 49.

[29] *See, e.g.*, MD. CODE ANN., BUS. REG. § 14-227 (West 2008).

[30] Mon-Shore Mgmt., Inc. v. Family Media, Inc., 584 F. Supp. 186, 194 (S.D.N.Y. 1984). The FTC tried to create a private cause of action. *See* Statement of Basis and Purpose, Ch. 7, Bus. Franchise Guide (CCH) ¶ 6366 (1979). However, *Mon-Shore* and other decisions have confirmed that no such right exists.

[31] *See* Petroleum Marketing Practices Act, 15 U.S.C. §§ 2801–2806 (2006) (giving petroleum distributors certain protections); Bus. Franchise Guide (CCH) ¶¶ 6540-6546; and *see* The Automobile Dealers' Day In Court Act, 15 U.S.C. §§ 1221–1225 (2006) (giving automobile dealers limited protection); Bus. Franchise Guide (CCH) ¶¶ 6520–6525.

The FTC initially considered whether to regulate franchise relationships and decided not to; when it amended the FTC Disclosure Rule in 2007, it again concluded that it should not assert jurisdiction over franchise relationship matters. *See* Statement of Basis and Purpose, 72 Fed. Reg. 15444, 15445–15449 (March 30, 2007).

Thus, by 1979, the environment for franchise regulation had been established. Since that time, changes within the regulatory environment have been minimal. Three states—Indiana, Michigan and Wisconsin—have junked their complex registration processes for what one might call "notice filings,"[32] and New York enacted a registration law in 1980.[33] On the relationship side, Iowa enacted a fairly broad statute in 1992, covering, among other subjects: terminations, non-renewals, rights of association and encroachment situations.[34] In 2007, Rhode Island enacted a relationship law,[35] modeled in many respects on the aggressive Wisconsin Fair Dealership Act.[36] The FTC also adopted amendments to the FTC Disclosure Rule early in 2007,[37] but for the most part the recent changes were long on procedural reforms, but short on substantive changes.[38]

The problems of having disclosure and registration laws enacted by numerous states acting independently from each other became apparent quickly. For example, a franchisor selling franchises in California and Illinois needed to provide different disclosure documents to the franchise prospects in the different jurisdictions—the California prospects received documents that complied with the California law, and, similarly, the Illinois prospects received disclosure documents that complied with that state's statute. While the disclosure documents required by each of the registration states had some commonality, the various state statutes, as well as administrative edicts, made the differences among these documents notable.

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[32] *See* IND. CODE ANN. § 23-2-25-10.5 (West 2008); Franchise Investment Law, MICH. COMP. LAWS. ANN. § 445.1508 (West 2008); Wisconsin Franchise Investment Law, WIS. STAT. ANN. § 553.26 (West 2008). In these jurisdictions, franchise registrations of notice are filed. However, unlike under the registration statutes, no review of the filing is made, and the registration becomes effective very quickly. In Michigan, for example, the registration goes into effect upon filing. MICH. COMP. LAWS ANN. § 445.1507a (West 2008).

[33] N.Y. GEN. BUS. § 683 (McKinney 2008).

[34] IOWA CODE ANN. § 523H.1 (West 2008).

[35] Rhode Island Fair Dealership Act, R.I. GEN. LAWS § 6-50-1 (2007).

[36] Wisconsin Fair Dealership law, WIS. STAT. ANN. §§ 135.05–135.07 (West 2008).

[37] *See* 16 C.F.R. § 436.1 (2008).

[38] *See* Susan P. Kezios, *Too Little, Too Late: The Franchisee's Perspective on the Revised FTC Franchise Rule*, 13 L.J. NEWSL.'S FRANCHISING BUS. & L. ALERT No. 8, May 2007, at 1; Kenneth R. Costello, *An Overview of the New FTC Rule*, 13 L.J. NEWSL.'S FRANCHISING BUS. & L. ALERT No. 6, at 1 (Mar. 2007); Rupert M. Barkoff, *Earnings Claims and the Amended FTC Disclosure Rule: Lamenting a Lost Opportunity*, L.J. NEWSL.'S FRANCHISING BUS. & L. ALERT No. 6, at 3 (Mar. 2007); Gerald C. Wells & Dennis E. Wieczorek, *The Top Ten Things You Need to Know*, 26 FRANCHISE L.J. 163 (2007); Rupert M. Barkoff, *The New, Improved (?) FTC Franchise Rule*, N.Y.L.J., May 2007, at 3; Kevin J. Moran and Max J. Schott, II, *The Amended FTC Rule: Much Ado About Nothing?*, 10 THE FRANCHISE LAWYER No. 3, May 2007, at 1; David J. Kaufmann, *Disclosure Under the Revised FTC Franchise Rule*, N.Y.L.J., May 2007, at 3.

Recognizing the need for more uniformity, in 1974, the Midwest Securities Administrators Association ("MSAA") early on established a committee that, working with the constituents within the franchise community, developed guidelines intended to bring some level of uniformity to the disclosure documents that franchisors needed to provide to prospective franchisees. The resulting disclosure document, known then as the Uniform Franchise Offering Circular ("UFOC"), and today referred to as the Franchise Disclosure Document ("FDD"),[39] eliminated many—but not all—of the disclosure differences previously found in the various state laws and regulations, thus, somewhat simplifying—but not wholly eliminating—all of the challenges facing franchisors in preparing disclosure sales documents for use in multiple registration states.[40]

The adoption of the FTC Disclosure Rule in 1979 only further complicated what was already a difficult situation for franchisors to deal with. While the FTC Disclosure Rule permitted franchisors to use the UFOC disclosure format, it also presented an alternative disclosure format ("the FTC Format"),[41] which could be used to satisfy the federal disclosure requirements. The states showed diplomatic hostility toward the FTC Format, and only one state, Illinois, approved it as an acceptable disclosure format. Most franchisors preferred the UFOC format since it would meet state disclosure requirements as well as those imposed by the FTC Disclosure Rule.[42]

After the implementation of the FTC Disclosure Rule in 1979, the regulatory environment surrounding franchise sales remained almost static for many years. The adoption of the FTC Disclosure Rule stemmed the tide toward more state regulation of franchise sales. As noted above, during the nearly thirty years that followed, only New York adopted new legislation

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[39] The franchise community has been debating what acronym to use for the new form of disclosure document required under the amended FTC Disclosure Rule, but appears to have settled on FDD, abandoning the soon to be nostalgic UFOC, which has been an acronym not only well known in the United States, but by franchisors and scholars in foreign jurisdictions who have kept their eyes on the United States regulatory scheme.

[40] The responsibilities of the MSAA have been taken over by the North American Securities Administrators Association ("NASAA"), which today, through its Franchise and Business Opportunities Task Force (the "NASAA Task Force") oversees franchise sales and registration regulation. Neither the NASAA Task Force nor NASAA itself has the authority to require states to adopt its recommendations; however, there is a clear trend for states to follow the guidelines recommended by the NASAA Task Force.

[41] *See* 16 C.F.R. § 436.1 (2008).

[42] The only perceived advantages to the FTC format were (1) the rules governing the use of earnings claims were more liberal, and (2) the FTC format allowed a phase-in with respect to the requirement that audited financial statements must be included in the disclosure document, while the UFOC required a full set of audited financial statements be included from the outset of the franchisor's franchise sales program. With the NASAA Task Force's decision to liberalize the rules governing earnings claims disclosures in the late 1980s, the already unpopular FTC format became even less attractive. *See infra* note 72.

governing franchise sales.[43] As for the UFOC itself, NASAA significantly changed the rules governing the use of earnings claims in the late 1980s[44] and overhauled the UFOC itself in 1993.[45] Otherwise, a picture of the franchise sales regulatory scheme taken in 2006 would almost completely resemble one taken in 1979. Even the amended FTC Disclosure Rule did little to change the landscape. The FTC jettisoned its FTC Format and pronounced that for federal disclosure law purposes, the traditional UFOC, subject to a dozen or so tweaks, would become the standard for franchise disclosure at the federal level.[46] The changes to the substantive disclosure requirements were relatively minimal, although there were some significant changes to the mechanics relating to franchise sales.[47] The amended FTC Disclosure Rule came into effect on July 1, 2007, but allows franchisors one year to adapt to the new requirements. Although the new federal requirements are not fully in sync with the existing state laws and regulations, the FTC and the NASAA Task Force are working together to minimize the differences between their respective disclosure requirements.[48]

A discussion of franchise regulation would not be complete without mention of another set of statutes, known as "business opportunities laws." These statutes have been adopted by twenty-five states and regulate the sale of business opportunities—generally defined as opportunities to start businesses.[49] These enactments were aimed primarily at the lower end of

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[43] See *supra* text accompanying note 33.

[44] For a brief discussion of what constitutes an "earnings claim," *see infra* note 72.

[45] The current UFOC Guidelines can be found at Bus. Franchise Guide (CCH) ¶¶ 5751 et seq. They become effectively obsolete on July 1, 2008, when the FDD becomes the disclosure standard for federal and essentially, state law purposes. The states may require additional disclosures to the FDD format so long as those disclosures enhance, and do not detract from, the level of disclosure.

[46] *See* Statement of Basis and Purpose, 72 Fed. Reg. 15444, 15445–15449 (March 30, 2007).

[47] *See supra* note 38.

[48] A successor committed to the NASAA Task Force eventually took over the oversight function of franchise regulation from the MSAA, and this group has since become this task force.

[49] Alaska, ALA. CODE §§ 45.66.010–.900 (2008); California, CAL. CIV. CODE §§ 1812.200–.221 (West 2008); Connecticut Business Opportunity Investment Act, CONN. GEN. STAT. ANN. §§ 36b-60 to -80 (West 2008); Florida Sale of Business Opportunities Act, FLA. STAT. ANN. §§ 559.80–.815 (West 2008); Georgia, GA. CODE ANN. §§ 10-1-410 to -417 (West 2008) (Disclosure obligation only; no registration required.); Illinois Business Opportunity Sales Law of 1995, 815 ILL. COMP. STAT. ANN. §§ 602/5-1 to -95 (West 2008); Indiana, IND. CODE ANN. §§ 24-5-8-1 to -21 (West 2008); Iowa, IOWA CODE ANN. §§ 551A.1–.10 (West 2008); Kentucky, KY. REV. STAT. ANN. §§ 367.801–.819 (West 2008); Louisiana, LA. REV. STAT. ANN. §§ 51:1821-1824 (2008) (Disclosure obligation only; no registration required.); Maine, (ME. REV. STAT. ANN. tit. 32, §§ 4691–4700 (2008); Maryland Business Opportunity Sales Act, MD CODE ANN., BUS. REG. §§ 14-101 to -129 (West 2008); Michigan Consumer Protection Act, MICH. COMP. LAWS ANN. §§ 445.902–.921 (West 2008); Minnesota, MINN. STAT. ANN.

distribution schemes, such as opportunities to place gift card racks in high volume traffic places or to develop mink or llama farms, but the definition of the term "business opportunities" was broad enough to cover mainstream franchises. Most of these statutes exempt offerings involving marketing plans that are accompanied by rights to use registered trademarks from the "business opportunities" definition.[50] Thus, most established franchisors will be exempt from the registration and disclosure requirements of these statutes, but this group of statutes further complicates the travails of newly established franchisors that may not have obtained registrations of their trademarks at the time they commence their franchise programs.

II. THE PROBLEMS WITH THE CURRENT FRANCHISE SALES REGULATORY SYSTEM

As a result of the regulatory scheme that has developed over the last thirty-eight years, selling franchises has become a tricky—and expensive—operation in this country. Is all this regulation necessary? Do we need franchise sales regulation in this country? Does it achieve the intended regulatory results, and does it do so efficiently?

Before answering these questions, I would like to take a quick look at the Australian regulatory scheme, and use it for purposes of comparison, for that country has so many similarities to the United States, and the method it has chosen to regulate franchise sales is conceptually similar to the United States system. Australian franchisors that want to enter the United States market through franchising, however, think we are, to be

§§ 80C.01–.17 (West 2008) (Business opportunity treated as a "franchise" under the definitions section); Nebraska Seller-Assisted Marketing Plan Act, NEB. REV. STAT. ANN. §§ 59-1701 to -1762 (LexisNexis 2008); New Hampshire Distributorship Disclosure Act, N.H. REV. STAT. ANN. §§ 358-E:1–6 (2008); North Carolina, N.C. GEN. STAT. ANN. §§ 66-94–66-100 (West 2008); Ohio, OHIO REV. CODE ANN. §§ 1334.01–.99 (West 2008) (Disclosure obligation only; no registration required.); Oklahoma Business Opportunity Sales Act, OKLA. STAT. ANN. tit. 71, §§ 801–829 (West 2008); South Carolina Business Opportunity Sales Act, S.C. CODE ANN. §§ 39-57-10 to -80 (2007); South Dakota (Business Opportunities Act, S.D. CODIFIED LAWS §§ 37-25A-1 to -55 (2008); Texas Business Opportunity Act, TEX. [BUS. & COM.] CODE ANN. §§ 41.001–.009 (Vernon 2007); Utah Business Opportunity Disclosure Act, UTAH CODE ANN. §§ 13-15-1 to -7 (West 2008); Virginia Business Opportunity Sales Act, VA. CODE ANN. §§ 59.1-262 to -269 (West 2008)(Disclosure obligation only; no registration required.); Washington Business Opportunity Fraud Act, WASH. REV. CODE ANN. §§ 19.110.010–.930 (West 2008).

[50] *See, e.g.*, N.C. GEN. STAT. ANN. § 66-94(4) (West 2008). Under the North Carolina law, the trademark must be federally registered. Under other states' laws, a state trademark registration might suffice. *See, e.g.*, GA. CODE ANN. § 10-1-410(2)(iii) (West 2008).

blunt, mad. After pondering about this contention, I think that they are right.

Australians take franchising very seriously, as do we in the United States. They brag that they are the second-most franchised country in the world on a per capita basis—New Zealand being first. Recent surveys show it has over 850 franchise systems that are of Australian origin. Although the number of franchise systems in the United States has not been comfortably identified, many estimate there are three to four thousand. Given that the population of Australia is only 20 million, as compared to the U.S. population that exceeds 300 million, this means that if the United States had a similar proportion of franchise systems per capita, there would be some 13,000 systems here. This, of course, would be a franchise lawyer's dream.

In 1993, franchising in Australia was essentially unregulated. Borrowing on the U.S. model to prevent what was perceived as abuses similar to those in the United States, the Australians adopted a Code of Conduct (the "Australian Franchise Code") in that year whereby voluntary disclosure was encouraged in connection with franchise sales. By 1998, a morphed version of the Australian Franchise Code had been adopted as law, and since that time, franchisors have been required to disclose to prospective franchisees information about their offerings.[51]

The Australian system of regulation, however, is considerably simpler than what we find in the United States. Even though Australia has a two-level federal and state structure of government, franchising sales regulation in that country is controlled purely at the federal level. The second distinguishing feature of the Australian franchise regulatory system is that there is no registration regime. Thus, the Australian scheme is similar to what would exist in the United States if the state regulatory schemes were eliminated altogether. The results are a regulatory system that is cheaper to administer from both the government's and the franchisor's perspective than what we find in the United States. Whether it is more effective is difficult to assess, but it is certainly more efficient. Unlike the FTC Disclosure Rule, the Australian model provides a private cause of action vested in the aggrieved franchisee if their Code is violated, in addition to enforcement powers being vested in the Australian Competition & Consumer Commission—a governmental agency that is the Australian counterpart to our FTC.[52]

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[51] Franchising Code of Conduct, 1998 (Austl.), *available at* http://www.comlaw.gov.au/ComLaw/legislation/legislativeinstrumentcompilation1.nsf/0/7A99D3F270266211CA257400007E885B/$file/TradePracIndCodeFranchRegs1998.pdf.

[52] Two other differences between the laws governing franchising in Australia and the United States are: (1) there is the equivalent of a good faith and fair dealing/ unconscionability provision in § 51AB of the Australian Trade Practices Act of 1974; and (2) the Australian Franchise Code requires suits to be sent to mediation before any

Keeping the Australian system in mind, let's return to our critique of the United States system and address the questions raised above.

A. Is There a Need for Franchising Sales Regulation in the United States?

If polled, I think the various constituents in the franchise community—franchisors, franchisees, franchise consultants, franchise lawyers, and government officials—would all readily shout, "Yes." The history of the abuses experienced in California before it adopted the California Franchise Investment Law, as well as the record developed during the 1970s by the FTC before it gave life to the FTC Disclosure Rule, provide more than adequate evidence of the need for regulation.

B. Does Our Regulatory Scheme Achieve Its Results?

Here, we have differences of opinion.

For the most part, franchisor advocates would say "yes." The compliance level with required disclosure is perceived to be remarkably high. There are no reliable statistics addressing this issue of which I am aware; however, my own observations are in accord, and I suspect that the other contributors to this Symposium would agree with my observation. Prospective franchisees are given valuable information to assist them in deciding whether to buy a franchise, and if so, which one.

Keep in mind, however, that the prescribed format contained in the UFOC (now FDD) does not give the prospective buyer a complete picture of a franchise system. As many franchise gurus have noted, the disclosure document is not the end of the due diligence process; it is only the beginning.[53] Franchisee prospects should expand the areas of investigation with respect to a franchise purchase beyond the subjects listed in the FDD. For example, some of the questions to be asked are:

- What is the overall relationship between the franchisor and its franchisees?
- Would existing franchisees buy the franchise again if they could start all over?
- Are franchisees increasing the number of franchised units they own?

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legal proceeding can be commenced. *See* Trade Practices Act, 1974, c. 4A, § 51AB (Austl.), *available at* http://www.austlii.edu.au/au/legis/cth/consol_act/tpa1974149/s51ab.html (last visited Mar. 14, 2009); Franchising Code of Conduct, 1998, c. 4, §§ 24-31 (Austl.).

[53] *See supra* text accompanying note 15; *See* SEID & THOMAS, *supra* note 20, at chs. 4, 6.

- Are changes in technology likely to make the franchised system obsolete?
- Is there a resale market for the franchises should the franchisee decide to bail?[54]

Critics of the United States system, however, shoot three arrows from their quiver. First, they note, there is no federal cause of action for violation of the FTC Disclosure Rule.[55] Thus, in the non-Registration states, the individual franchisee must fall back on common law fraud claims in order to prevail over any injustices. As noted earlier, the challenge of proving fraud can be Herculean.[56]

The second criticism focuses on the FTC itself. Like so many other governmental agencies, it has been given a gigantic mission, but limited resources to carry out its mandate. Thus, triage has been the necessary strategy followed by the FTC in the area of franchise sales regulation enforcement. It looks for situations where the fraud is blatant and where there is widespread injury to the public. The individual franchisee that has been injured typically is left on his own to pursue justice. The Registration States have provided a cure for this problem, but recall only fourteen out of fifty states provide statutory protection.

The third criticism about the franchise disclosure regime starts with the broader premise that for franchising to be fully and properly regulated, disclosure is too narrow an approach. Advocates of this theory argue that franchise relationship issues are as necessary a part of franchise regulation as are rules governing disclosure. This group is disappointed that the FTC did not expand its Franchise Disclosure Rule when the rule was recently amended, and they also are critical with respect to the state relationship laws. They view these laws as being too little, and geared to abuses that may have been the main source of attention in the 1970s, but do not adequately address the problems of today.[57]

C. *Is Franchise Sales Regulation Efficient?*

The answer is "no," and, with the possible exception of government officials, I perceive that there is consensus on this issue. Franchisors, clients and non-clients of mine, and franchisor-oriented lawyer colleagues have confirmed to me their position that the system does not work efficiently. Even many franchisees and lawyers who represent franchisees will, although less enthusiastically, agree. And while the state and federal

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[54] For a more expansive list of due diligence questions, *see* BARKOFF & SELDEN, *supra* note 16, at 284-85.

[55] *See* Mon-Shore Mgmt., Inc. v. Family Media, Inc., 584 F. Supp. 186 (S.D.N.Y., 1984) (the FTC tried to create a private cause of action and failed); Statement of Basis and Purpose, Ch. 7, Bus. Franchise Guide (CCH) ¶ 6366 (1979).

[56] *See supra* text accompanying note 15.

[57] *See* BARKOFF & SELDEN, *supra* note 16, at 295.

regulators may or may not take this view, their efforts to try to streamline the disclosure system implicitly recognize that the system is inefficient and could stand improvement.[58]

D. *What are some of the Perceived Inefficiencies?*

1. *The Dual Level of Regulation*

Is there a need for regulation at both the federal level and the state level? Is it duplicative?

A response: Given the absence of a private cause of action under the FTC Disclosure Rule, the Registration States' laws give an added dimension to the enforcement of the rights granted to aggrieved franchisees. Moreover, the existence of these states' laws means more resources in the enforcement area—an important element given the shortage of resources available to the FTC.

2. *The Variations in State Laws*

Do all state laws provide the same scope of protection? To borrow from the Hertz advertisement of several years ago, "Not exactly." While, the disclosure and registration laws of the Registration States are all very similar, they have their differences. Most states have adopted the UFOC Guidelines (and what are now, effectively, the disclosure requirements contained in the Amended FTC Rule) in substantial part, but most states nevertheless have their own idiosyncrasies. Sometimes these are statutory. For example: statutes have different definitions for a "franchise,"[59] different statutes of limitations,[60] and different exemptions, to name only a few areas where there may be differences. Different administrative rules or internal informal procedures provide even more opportunities to destroy uniformity.[61] Whatever the source, the lack of uniformity in statutes and regulations clearly makes the sales process more cumbersome, and, consequently, less efficient.

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[58] The implementation of the "Coordinated Review" process to streamline the registration process has so far proven to be a failed experiment. *See infra* text accompanying note 63.

[59] *See supra* text accompanying note 3.

[60] *See* CAL. CORP. CODE § 31303 (West 1971) (generally four years for making fraudulent representations); § 31304 (two years for failure to register). The Washington Registration Law has no specified statute of limitation; the general statute of limitation is two years. *See* WASH. REV. CODE § 4.16.080 (West 2008) (three years after the date of discovery for fraud); § 4.16.040 (six years for contract claims); § 4.16.130 (two years for claims where a statute of limitation is not specified).

[61] Most if not all, of the other Registration States grant the state authorities the right to exempt certain transactions from the registration on disclosure obligations under the state's Registration Law. *See, e.g.*, ILL. ADMIN. CODE, tit. 14, § 200.201 (West 2008).

3. The Review Process

There are two issues here. First, does state review of disclosure statements add any value to the disclosure process? Effectively, thirty-six non-Registration States do not review and comment upon disclosure documents. In addition, three of the Registration States—Indiana, Michigan and Wisconsin—no longer review disclosure statements. These states have become, in essence, simply filing states.

Unfortunately, we have no statistics showing whether fraud is more common in those states that review disclosure statements than in those states that do not.

Even if review is beneficial, there is a second issue: Whether it is necessary to have up to eleven different reviews of a franchise registration application; that is, review by governmental officials in each of the Registration States (other than Indiana, Michigan and Wisconsin)? Do multiple reviews significantly improve the quality of disclosures to franchisees?

Again, I am unaware of any statistical studies that address this issue, but my anecdotal experiences suggest that the multiple reviews create more problems than they solve. They often end up with franchisors having to use different disclosure documents for different states, which means more administrative time and cost for the franchisor, and the benefits of these additional disclosures are, in my experience, marginal, if any.

The state regulators have tried to address the multiple review issue. In 2004, they instituted a "Coordinated Review" process, whereby a franchisor could submit registration applications in up to eleven jurisdictions simultaneously, and then work with a franchise examiner from only one jurisdiction who had responsibility for gathering the comments from his or her colleagues in other jurisdictions, and transmitting these comments to the applicant.[62] The applicant would then deal with just one administrator, rather than representatives from up to eleven jurisdictions. The Coordinated Review process received mixed reviews from the critics, and on July 31, 2007, its use was suspended as the state examiners concluded that they needed to focus their limited resources on challenges created by the amendments to the FTC Disclosure Rule.[63] Whether Coordinated Review will ever be taken out of purgatory is anybody's guess.

In summary, there is an identified need for regulation, but the response has been a system that is not inefficient, and, in some eyes, ineffective. This leads to the next question, which is: What are we to do? Are appropriate corrections of these flaws possible?

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62 *See* Coordinatedreview.org, http://www.coordinatedreview.org/ (last visited Mar. 14, 2009).

63 Adam J. Siegelheim, *Coordinated Review Program Indefinitely Suspended*, New Jersey Law Blog, Oct. 3, 2007, http://www.njlawblog.com/2007/10/articles/franchise/coordinated-review-program-indefinitely-suspended/ (last visited Mar. 14, 2009).

III. THE BARRIERS TO MAKING THE FRANCHISE SALES PROCESS MORE EFFICIENT

Putting aside for the moment the political barriers that may inhibit more efficiency being injected into the franchise sales process, there are several barriers that are structural in nature that present challenges. These structural barriers include the following:

A. The Dual Level of Regulation

The state regulators view franchise disclosure as their baby. Like crime dogs, they were on the scene trying to address the problem while the FTC was in the incipient stages of holding hearings to determine whether there was a problem that warranted government intervention. The states, I believe, will not give up their authority without a fight, or without receiving some significant concessions in exchange for a restriction on their ability to regulate. The federal government could opt to preempt state power, but that would be a politically touchy approach, which is likely to harden feelings between the federal and state governments. To the FTC's and state administrators' credit, working through the NASAA Task Force, they have tried diligently to improve the franchise sales process. However, absent preemption, this is like putting a band aid on a large knife-wound.

B. The Differences in the Registration Laws

As noted above, while there are great similarities among the state statutes governing franchise sales, there are also notable differences. The basic definition of a "franchise" varies among these statutes. In most statutes, there are three prerequisites for a distribution arrangement to be characterized as a franchise: trademark association, control, and payment of a fee.[64] However, in New York, only the fee element and either the trademark association or control tests are necessary for an arrangement to be called a franchise.[65]

The exemptions vary considerably among jurisdictions. California, for example, has an experienced investor exemption[66] as well as a fractional franchise exemption.[67] However, there is little to be gained from relying

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[64] *See supra* text accompanying note 3.

[65] N.Y. GEN. BUS. § 681.3 (McKinney 1981).

[66] CAL. CORP. CODE § 31106 (West 1996).

[67] In essence, a "fractional franchise" refers to an opportunity to add a product or service line of a similar nature to an existing franchise where the additional product or service will result in a relatively small proportion of the franchisee's overall sales. *See,*

upon the fractional franchise exemption if that exemption is not available in all jurisdictions.[68] Many of the other statutes do not have either exemption.

1. *The required substantive disclosures may differ from state to state.* As noted above, most of the Registration States will require the disclosure document to include certain information about applicable state law. California, for instance, does not permit franchisors to require out of state dispute resolution.[69] Indiana law prohibits terminations of the franchise without good cause or in bad faith.[70]

2. *Most states have regulations that exacerbate the underlying differences among the states' regulatory schemes.* For example, Minnesota regulations exempt, under certain circumstances, one-off sales. The other states have no comparable exemptions for isolated transactions, although some will exempt isolated sales pursuant to individual requests for exemptions.

3. *Administrative discretion also presents challenges.* In interpreting their statutes and regulations, franchise examiners have been granted broad discretion. This again means that there is likely to be more inconsistency among the states' application of their respective franchise disclosure regulatory schemes.

4. *The level of scrutiny given to franchise disclosure document review varies enormously among the states.* One examiner informally told me that if State X has already reviewed a registration statement and had issued an effective order, their subsequent review would be more cursory than might otherwise have been the case. The fact that examiners in different states may require changes to the disclosure document also lessens the chance of achieving more efficiency. And finally, even within a particular state agency, examiners may take different positions. For example, several years ago, one office within the California Department of Corporations required franchisors who wanted to make "financial performance representations"[71] to provide several levels of information

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e.g., CAL. CORP. CODE § 31108 (West 2000); FTC Disclosure Requirements and Prohibitions Concerning Franchising Rule, 16 C.F.R. § 436.1(g) (2008).

[68] For franchisors who are trying to sell franchises in multiple jurisdictions, it does little good to be exempt from registration in say, California, if it will still be required to prepare its disclosure documents to be able to sell in other jurisdictions. The economic savings will be relatively minimal.

[69] CAL. BUS. & PROF. CODE § 20040.5 (West 2008).

[70] IND. CODE ANN. § 23-2-2.7-1(7) (West 2008).

[71] "Financial performance representations," known as "earnings claims" prior to the implementation of the Amended FTC Disclosure Rule, are a story unto themselves. Generally, franchisors are not allowed to use information that indicates a specific level of sales or income unless there is a reasonable basis for the information to be provided, and that information is included in the FDD. See U.F.O.C. Guidelines, Bus. Franchise Guide (CCH) ¶ 5919. While the Amended FTC Disclosure Rule changed the name of this kind of disclosure, it did not materially change the nature of the required disclosures themselves. A franchisor is not required to make financial performance

concerning expenses (such as labor, costs of goods sold and occupancy), while another office would permit financial performance representations that only disclosed gross revenues.

5. Consideration must be given to the "Human Factor." Examiners change their opinions over time, reviews are sometimes switched from one examiner to another, and examiners come and go, all of which means that disclosure previously made and found acceptable by state officials in the past may no longer be acceptable. This human element of the franchise registration process may be the greatest of all these barriers.

If uniformity in disclosure is an admirable goal, all of the above barriers make that goal a nearly impossible dream.

IV. WHO ARE THE CONSTITUENTS THAT NEED TO COALESCE, AND WHAT MIGHT BE STRATEGIES THAT BRING MORE EFFICIENCY TO FRANCHISE SALES REGULATION?

Let us consider first, who are the constituents in the franchise regulatory arena; second, what are some of the ways in which the United States regulatory system could be improved; and third, how those constituents are likely to react to such proposals.

The constituents are:

- *Franchisors and their legal counsel.* Both groups are likely to consider the current system as their base line and not willing to consent to change unless there are notable perceived improvements that work toward their benefit.
- *Existing franchisees.* This group would at first glance not appear to have any interest in this problem. However, existing franchisees are often the best customers for buying additional franchises.
- *Prospective franchisees.* This group obviously has a significant interest in the process, but it is not truly represented in the process, except indirectly. There is no organized group of prospective franchisees; thus, it will be up to other constituents to see that they are represented.
- *Franchisee lawyers.* Although they have a direct economic stake in the process in that their revenue stream may be dependent on how easy or difficult it may be to prosecute or defend cases on behalf of franchisees, they are

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representations, which in itself has been a subject of intense debate. See Revised Statement of Basis and Purpose, 73 Fed. Reg. 15,445 (March 30, 2007). *See also* Rupert M. Barkoff, *Earnings Claims and the Amended FTC Disclosure Rule: Lamenting a Lost Opportunity*, L.J. NEWSL'S FRANCHISING BUS. & L. ALERT No. 3 (Mar. 2007).

also likely to be one of the advocates for prospective franchisees. For example, several franchisee lawyers submitted comments promoting the interests of prospective franchisees during the rule-making process for the amended FTC Disclosure Rule.[72]

- *The FTC.* Clearly, the advocate for the federal government.
- *State regulators.* The advocates for the state governments and also an indirect proponent of the interests of prospective franchisees—the group whose interest they are charged to protect.

Reform proposals might include the following:

1. Complete federal preemption, including sales disclosure and relationship matters. Although this would be the simplest solution, it is also one that is completely unrealistic. Compared to the Australian model described above, it is even more drastic in that under Australian law the state laws still govern issues other than disclosure—that is, relationship matters, except to the extent relationships are regulated by §§ 51-52 AC of the Australian Code of Conduct.[73] Franchisors and their attorneys might relish this proposal,[74] but franchisees and their advocates, including franchisee-oriented attorneys, would vehemently oppose the proposition unless there were some significant concessions made to the franchisee community. These might include adoption of a private right of action for breach of the FTC Disclosure Rule, or the enactment of a federal statute setting forth the rights of franchisees with respect to relationship issues. These bills have been introduced on several occasions, and never moved very far through the halls of Congress.[75] State officials are also likely to be vehemently opposed to this approach. This proposal would mean giving up turf to an area where mentally, I believe, they think they are king. How the FTC would react is more difficult to ascertain. Although one might think government officials would find the idea of additional power attractive, I

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[72] *See* 72 Fed. Reg. 15,444. Excerpts or summaries from these comments can be found interspersed throughout the Revised Statement of Basis and Purpose. See, e.g., Revised Statement of Basis and Purpose, notes 37, 50, 408, and 582 and accompanying text.

[73] See *supra* text accompanying notes 51.

[74] On the other hand, there is always a fear that once a regulatory issue is brought into any legislative body for consideration, the process can get out of control. Thus, franchisor interests may prefer to let the sleeping dog lie.

[75] H.R. 1316, 103d Cong. (1st Sess. 1993) and H.R. 1317, 103d Cong. (1st Sess. 1993). Congressman John J. LaFalce of New York introduced both of these bills, as well as a bill that would require the Commerce Department to gather certain information relating to franchising, H.R. 1315, 103d Cong. (1st Sess. 1993). In 1998, another attempt was made to enact franchise relationship legislation—the so-called Coble-Conyers Bill, officially known as the Small Business Franchise Act of 1998, H.R. 4841 105th Cong. (1998). The bill made no progress in Congress.

have not sensed that this is a fight the FTC wants to be involved in. In any event, given that federal legislation would be necessary to create a private right of action, the probability of this happening, given the likely opposition, is remote.

2. Partial preemption, covering registration and disclosure, but not relationship or enforcement. This approach goes a long way toward eliminating franchisee opposition. From the franchisor vantage point, it eliminates the unnecessary duplication of multiple reviews and the associated cost and time spent participating in this process. From the franchisees' perspective, if a concession such as a federal right of private action were coupled with the proposal, it might be very appealing. Adequate staffing support within the FTC would also be an attractive carrot for this constituency.

How state and federal officials might view this proposition presents an intriguing intellectual exercise. The proposal would free up resources for enforcement. The states would be eliminating costs without necessarily sacrificing the rights of their constituents. However, the states' attitude of entitlement, due to their long-standing supervision of this area, might ride paramount in deciding where they would line up in this process.
How the FTC might view this would depend on whether filings or reviews were part of the package, how much additional funding might it receive, and how much more responsibility that agency is willing to undertake. This, again, might not be a burden the FTC would like to accept.

The model, I should note, has strong resemblances to what now happens in the securities industry, and a glance at the success or lack of success of how blue-sky regulation has melded with federal securities law would probably be meaningful for the franchise community. My understanding is that the states have limited their role in public offerings, but the blue-sky laws nevertheless remain in place.

3. Amend state statutes to make them identical with each other. This is what I would call a half-solution. It leaves out protection for prospective franchisees in thirty-six jurisdictions because of the lack of a private right of action under the FTC Disclosure Rule. Moreover, trying to achieve uniformity in statutory provisions is an arduous task. In 1987, the National Conference of Commissioners on Uniform State Laws proposed a Uniform Franchise and Business Opportunities Act. It was introduced for consideration in two jurisdictions; however, it received little attention. Nonetheless, assuming there was statutory uniformity, there might not be administrative uniformity as a result of the "Human Factor" identified above. Thus, while this proposal has some appeal, it is not likely to achieve wide-sweeping efficiency. On the other hand, it likely could receive the appropriate political support from all constituents—the primary question being whether the improvements in efficiencies warrant the time commitment.

4. Bring back Coordinated Review and expand it to cover renewals. This is an attractive alternative, but not one that is likely to receive widespread enthusiasm. Neither the governmental officials nor many in the franchise bar were initially fond of this program. It removes the burden on franchisor counsel to deal with officials from all but one of eleven Registration States, and, instead, makes the state examiners deal with each other. It is not clear that there is an efficiency gained here, although there is clearly a redirection of resources involved in the process from the private to the public sector. Stated differently, franchisors' legal costs should decrease, more effort would be required by the state officials.

5. Outsource. Hire a company to develop a group of qualified examiners and have each state contract with this company to manage the registration process for them. This process would certainly be better than today's system in that it would eliminate the eleven separate reviews and substitute one in its place. It would also reduce the likelihood of inconsistent reviews as well as reduce the problems caused by the Human Factor.

6. Do nothing. To quote the Beatles, "Let It Be!" That is, leave the system as it is today. In the eyes of some of the franchise constituents, being broken may be better than opening Pandora's box.

V. CONCLUSION

In my working career lifetime, I doubt we will see a meaningful shift in how franchise sales are regulated. But while there has been banter about this subject throughout the years, it is time for this subject to be given serious attention again by all of the franchise community constituents. I would not go so far as to say that the United States system is broken, but I would contend that there are significantly better ways to regulate franchising. However, to start an endeavor such as this, the various constituencies must buy into this premise, and be willing to look at franchising as a whole rather than at their own parochial positions.

We must recognize, as Thomas Friedman has suggested, that the world is flat.[76] Franchise regulations were invented in the United States, and are here to stay. The only question is how intensive the regulation should be. The leading role played up to now by the United States internationally is being diluted, as other countries turn to franchising as a distributing method, and that is, without doubt, bad from the United States' perspective. Our regulatory system discourages both domestic and foreign usage of franchising as a distribution technique.

My hero of literature is Don Quixote, for he was always up for a fight, even when he was far from being the odds-on favorite. Franchising is

[76] THOMAS L. FRIEDMAN, THE WORLD IS FLAT: A BRIEF HISTORY OF THE TWENTY-FIRST CENTURY (Farrar Straus and Giroux eds., 2005).

faced with a similar challenge today. Hopefully, like the "Man of LaMancha", the leaders of the franchise community will step up to this enormous challenge.